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(Re)Testing the 'follow the customer' hypothesis in multinational bank expansion

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Abstract

Theory suggests that multinational banks follow their corporate and non-corporate customers. Previous empirical studies have tested the hypothesis that multinational banks follow their corporate customers. This study bridges a gap between the theory and previous empirical studies by testing the hypothesis that multinational banks also follow their non-corporate customers. We accomplish the purpose by empirically testing a model of the effect of home country factors on multinational bank expansion. Our results support the hypothesis that multinational banks also follow their non-corporate customers.

JEL classification: D82; F21; G21

Keywords: Asymmetric information; Banks; Foreign direct investment

1. Introduction

The most important monopolistic advantage in multinational bank expansion is the reputation amongst domestic customers and a special knowledge of their needs. This advantage, based on relational contracting (Williamson, 1981), gives banks a privileged opportunity to follow their customers abroad. The 'follow the customer'

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strategy is well known in the literature (Tschoegl, 1987).[1] The internalization theory (Buckley and Casson, 1976; Tschoegl, 1987; Casson, 1990)[2] asserts that this strategy can be applied not only to corporate customers but also to non-corporate customers such as permanent immigrants and non-citizen permanent residents. Previous empirical studies have focused on testing the 'follow the corporate customer' strategy. This study bridges a gap between the theory and previous empirical studies on multinational bank expansion by testing the hypothesis that banks also follow their non-corporate customers to provide financial services to these customers in the foreign country.

To accomplish the purpose, we test two sets of three hypotheses related to the effect of home country factors on multinational bank expansion in the United States (U.S.). In this context, we extend Grosse and Goldberg's (1991) model of the effect of home country factors on foreign bank expansion by incorporating the non-corporate customer hypothesis. An extensive justification for the choice of the U.S. as the host country can be found in Hultman and McGee (1989), Grosse and Goldberg (1991). From the standpoint of this study the choice of the U.S. enables us to make a direct comparison with the results in Grosse and Goldberg (1991). The first set of hypotheses (H1–H3) is related to the 'follow the customer' strategy, and the second set of hypotheses (H4–H6) is related to other home country factors that affect multinational bank expansion. Specifically, our main hypothesis (H1) is related to the 'follow the non-corporate customer' strategy, and all the other hypotheses are simply controls. Testing the effect of home country factors in a single host country (in this case, the U.S.) controls for host country effects that can obscure the home country factors of interest to the study. Focus on foreign bank expansion into a single host country also permits the role of bilateral international factors to be examined (Tallman, 1988).

The paper is organised as follows. Section 2 describes the hypotheses and variables concentrating on the reasons the selected factors affect multinational bank expansion and presents the model to be tested. Section 3 describes the data and methodology. Section 4 reports the empirical results and Section 5 includes a summary and conclusions.

2. Hypotheses and model

The literature on multinational bank expansion stresses the importance of the 'follow the customer' strategy, suggesting that banks follow customers as they move abroad. Previous empirical studies have often dealt with factors such as trade patterns between home and host countries or the level of manufacturing foreign investment. Importance of other factors has also often been mentioned. However, and despite theoretical analysis, the role of non-corporate customers has lacked

[1] This paper also provides an extensive discussion of monopoly advantages in multinational bank expansion.

[2] In a recent review Williams (1997) contends that the internalization theory offers greater internal consistency in relation to the eclectic paradigm (Dunning, 1977) for studying the multinational bank.